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Fiscal Process Frozen

Although the ruling Liberal Democratic Party coasted to victory in recent lower house elections, determined opposition parties have continued trench warfare to frustrate government efforts to obtain legislative approval of vital spending bills. With the end of the fiscal year (March 31) fast approaching and prospects dim for a compromise between the LDP and the opposition on important fiscal issues, Diet approval of the FY 1989 supplemental budget is certain to go down to the wire. Work on the spending plan for the new fiscal year accordingly will be delayed. This fiscal freeze is unlikely to harm the nation's economy but may have an adverse impact on Japan's external relations.

The Y5.9 trillion ($39.3 billion at Y150=$1.00) supplemental authorization contains money for disaster relief programs, government salary increases and public works projects, to name a few (see JEI Report No. 1B, January 5, 1990). The LDP originally had hoped to pass the supplemental FY 1989 spending

While the 5 percent ceiling on bond issues has no economic rationale, MOF's real intention is to finance part of public works spending by general tax revenues rather than construction bonds. The proposed FY 1990 budget for public works is around Y6.2 trillion ($41 billion), of which 91.6 percent is expected to be financed through new construction bond issues. If the Council on Fiscal Policy's target is achieved in FY 1995, however, construction bonds will cover only 53.9 percent of public works expenditures, which also are projected to increase 4.75 percent a year and reach nearly $7.8 trillion ($51.7 billion) that year. Obviously, if the economy stumbles and tax revenues decline significantly, the government will have to issue more construction bonds. But MOF believes the government will be able to avoid a return to deficit financing by expanding issues of construction bonds in periods of slow growth.

MOF's new fiscal goal is certain to cause a confrontation with Washington, which has asked Tokyo in the Structural Impediments Initiative talks to increase spending on infrastructure (see article in this issue). The Bush administration wants the government to raise the ratio of public investment to gross national product to 10 percent within five years. For FY 1990 that figure is estimated at 6.6 percent.

To illustrate what it would take to reach the 10 percent ratio, Nihon Keizai Shimbun recently calculated that in FY 1988 public works spending would have had to increase by Y4.1 trillion ($27.3 billion). Actual public works spending that year was up Y1.2 trillion ($8 billion), but only because the government earmarked that amount from the proceeds of its sale of Nippon Telegraph and Telephone Corp. shares. This implies that an additional Y6 to Y7 trillion ($40 to $46.7 billion) would be needed in FY 1995 to meet the U.S. request. This is a nearly impossible task given the government's intention to reduce new issues of construction bonds and the unlikelihood that a big tax increase would be enacted to achieve that end.

In addition to the five-year fiscal goal, the Council on Fiscal Policy's March 1 report included the following recommendations:

- Deficit-financing bonds should be redeemed as early as possible to cut interest payments and the total outstanding debt, which is expected to reach Y164 trillion ($1.1 trillion) by the end of FY 1990. This suggests that bond redemption be front-loaded despite the official 60-year redemption period.

- Transparency should be implemented in the budget process as soon as possible to eliminate smoke-and-mirror measures, which were introduced to make the government deficit look smaller in the early 1980s.

- The government should keep increases in total expenditures equal to or less than the nominal GNP growth rate.

Hideo Takahashi

Japanese Firms Plan Higher Investment In FY 1990

On the eve of Japan's new fiscal year, which begins April 1, Japanese firms are planning to spend more on new plant and equipment than they did during FY 1989, when investment hit record levels. That is what a number of

government and private surveys of corporate investment plans indicate, as summarized in Table 1. Surveys limited to the largest Japanese firms show a spending increase of almost 9 percent in nominal terms; more comprehensive investigations that include small and midsized firms point to a smaller, but still substantial, boost.

Table 1: Surveys of Plant and Equipment Spending

	Most recent survey	Number of firms	FY 1987 (actual)	FY 1988 (actual)	FY 1989 (estimated)	FY 1990 (forecast)
Nihon Keizai Shimbun	2/90	1,484	1.1%	14.5%	16.3%	8.7%
Japan Development Bank	2/90	1,958	4.4	18.8	17.4	8.6
Economic Planning Agency	12/89	4,475	10.6	26.7	21.0	n.a.
Nominal Plant and Equipment Spending*	--	--	7.5	16.8	14.3	7.6

*Gross national product basis. The FY 1989 and the FY 1990 figures are based on the government's economic outlook for FY 1990, which was announced in December 1989.

In past years such early predictions have proven to be extremely conservative. For example, in February 1989 the firms surveyed by the Japan Development Bank expected to increase spending 6.8 percent in FY 1989; resurveyed last month, they said the boost would come to 17.4 percent. Similarly, the initial FY 1989 survey by the Nihon Keizai Shimbun, the economic daily, showed an expected 6.8 percent gain, but now firms are anticipating a 16.3 percent increase.

Washington views the current FY 1989 figures with some alarm, suggesting that the higher investment spending levels could lead to an export boom. American policymakers presumably are most interested in the manufacturing sector, which has shown slightly higher capital spending increases than nonmanufacturing (see Table 2). Some prominent Japanese exporters, such as automotive manufacturers, have hiked spending during FY 1989 and are almost as upbeat about the coming fiscal year. Their FY 1990 projections, especially if they prove as conservative as they have in the recent past, would appear to make the prospect of an export surge even more likely in Washington's view.

Tokyo has responded that increased plant and equipment spending is not directed toward additional capacity. Of course, insofar as modern plant and equipment replace dated facilities or research and development expand as a result of higher spending, the competitiveness of Japanese firms in the international market grows. In such a situation the Japanese economy absorbs more savings in the short run to finance the new plant and equipment, which implies

smaller capital outflows, other factors being equal, and smaller current account surpluses. Over the course of several years, however, a larger Japanese

Table 2: Plant and Equipment Spending by Industry, FY 1989 and FY 1990

(percent change compared to previous year)

	FY 1989 (estimated)	FY 1990 (projected)	FY 1990 Share of Total Plant and Equipment Spending
All Manufacturing Firms	26.6%	10.5%	50.4%
Food	15.9	3.1	3.4
Textiles	8.7	5.8	1.9
Paper and Pulp	18.5	6.0	2.0
Chemicals	26.8	10.0	4.9
Pharmaceuticals	28.8	13.6	1.1
Petroleum	25.9	28.2	1.3
Rubber	33.7	14.1	0.7
Glass and Stone	22.0	22.5	1.8
Steel	39.6	8.8	4.3
Nonferrous Metals	40.8	13.2	2.4
Nonelectric Machinery	34.8	18.2	3.0
Electric Machinery	27.9	7.1	11.9
Ships	-0.5	7.7	0.7
Motor Vehicles	27.2	14.7	8.2
Other Transport Equipment	72.6	28.9	0.2
Precision Instruments	22.9	11.4	1.1
Other Manufacturing	26.2	5.6	1.5
All Nonmanufacturing Firms	7.7	7.0	49.6
Fisheries	48.6	-24.4	0.0+
Mining	15.4	47.0	0.2
Construction	21.5	25.3	2.8
Trading Companies	6.4	-3.8	1.4
Retailing	17.7	16.8	3.6
Other Financial Companies	-49.7	42.6	0.0+
Real Estate	25.5	16.0	2.3
Railroads and Buses	19.3	1.0	4.4
Other Land Transportation	25.0	10.1	0.4
Sea Transportation	36.6	-40.4	0.2
Air Transportation	27.2	31.5	2.4
Warehousing	23.1	37.1	0.5
Communications	0.0	0.6	9.1
Electric Power	1.5	6.2	19.6
Gas	10.8	-7.5	1.4
Services	18.9	10.8	1.3
Total	16.3	8.7	100.0

Source: Nihon Keizai Shimbun

economy would result from the boost in capital spending, with imports and exports both higher than otherwise and uncertain consequences for the current account.

Of course, beleaguered U.S. companies are not likely to welcome the news that Japanese exports could be headed higher. Such firms may take some consolation from the prospect that investment levels could end up substantially lower than currently expected. The most recent of the surveys summarized in Table 1 were taken after interest rates rose late last year and the Tokyo stock market began declining in January; they do not, however, reflect the continuation of these trends into late March. Should financial markets remain weak, firms counting on raising money from selling equity or borrowing to finance their spending plans could have difficulty meeting their objectives.

In addition, a growing number of Japan's corporate leaders see the prospects for the balance of 1990 as unfavorable. For example, a poll taken in early March by Asahi Shimbun, one of the country's largest dailies, found a bare majority of the 100 top corporate executives in Japan expecting an economic downturn by the end of the year. In the same survey 67 percent said that the economic expansion is continuing, down from 95 percent in the previous poll taken a year earlier. Should higher interest rates come to be paired with a projected overall slowdown, investment plans could be scaled back dramatically. With plant and equipment spending equaling almost 20 percent of the Japanese economy, the effect on economic growth would be significant.

Douglas Ostrom

Shipping Companies Escape Shoals

Although initials such as NYK, "K" Line and Mitsui OSK long have been fixtures on the American waterfront, another set of familiar maritime initials -- SOS -- often has better described Japanese shipping companies in recent years. In fiscal 1986, which ended March 31, 1987, and again in FY 1987 the companies lost hundreds of millions of dollars on their international business. However, more recently the largest firms, at least, have returned to profitability. The four largest shipping companies recorded profits of Y19.7 billion in FY 1988 ($130 million at Y150=$1.00) and are expected to earn Y33.5 billion ($223.3 million) in the year through March.

As they have struggled to overcome problems, shipping companies unwittingly have highlighted structural issues potentially facing many Japanese industries. One response to their difficulties, for example, has been merger and/or retrenchment. In 1988 Japan Line Ltd. and Yamashita-Shinnihon Steamship Co., Ltd. formed a new company, Nippon Liner System Ltd., to operate the two firms' North American liner freight services. Then last June the two shippers combined all of their operations to form Navix Line, Ltd., the fourth-largest company after Nippon Yusen K.K., Mitsui OSK Lines, Ltd. and Kawasaki Kisen Kaisha, Ltd. In addition, Showa Line, Ltd., another of the traditional big six Japanese shippers, abandoned its North American liner service in early 1988. Even NYK and Mitsui OSK, the industry's leaders, have been forced into some joint projects.

As has happened in other industries facing restructuring, keiretsu and other corporate groups have played a major role in the reorganization of the